Testimony of

R. Bradford Huss, Esq.
Partner, Trucker Huss
San Francisco, California

on behalf of

ASPA
4245 North Fairfax Drive, Suite 750
Arlington, VA 22203-1619

at a hearing on

Retirement Security:
Picking Up the Enron Pieces

before the

Senate Finance Committee
Washington, D.C.

February 27, 2002

Introduction

Mr. Chairman, members of the Committee, thank you for inviting me to testify today on retirement security and possible proposals to reform our nation's pension laws. My name is Brad Huss and I am an attorney and a member of the law firm of Trucker Huss in San Francisco, California. Trucker Huss is one of the largest employee benefits specialty law firms in the country. Our firm provides services for a diverse array of retirement plans maintained by large and small corporate employers, union-management joint boards of trustees, state and local governments and non-profit entities. I personally have been practicing employee benefits law since 1977, when the Employee Retirement Income Security Act of 1974 (ERISA) became effective. I am the head of our firm's ERISA litigation department and my practice also includes counseling clients on the fiduciary responsibility rules of ERISA. I have been actively litigating ERISA cases for over twenty years and I have represented plan participants and beneficiaries as well as employers, plan fiduciaries and third party service providers.

I am also a member of the Board of Directors and a co-chair of the Government Affairs Committee of ASPA, on whose behalf I am testifying today. ASPA is a national organization of over 5,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. The vast majority of these plans are maintained by small businesses. ASPA members are retirement plan professionals of all types, including consultants, administrators, actuaries, and attorneys. ASPA's membership is diverse, but united by a common dedication to the private pension system.

ASPA shares the concerns of this Committee, of the Congress, and of America about the tragic consequences arising from the bankruptcy of Enron. We applaud this Committee's leadership in exploring whether and how our nation's pension laws may need strengthening. We also commend the Committee for its stated commitment to maintaining the framework of laws upon which is built a strong, employer-based system of providing retirement income benefits to our nation's workers. However, it is critically important that any legislative response to the Enron tragedy be carefully measured. We certainly do not want to impose rules that will result in reduced retirement plan coverage. In particular, we need to carefully consider any new burdens that may be imposed on small businesses that are already struggling to provide retirement benefits to their employees.

I would like to summarize ASPA's views on several issues concerning the fiduciary rules under ERISA in light of the problems concerning the Enron Corporation 401(k) plan. ERISA imposes fiduciary duties concerning the management of pension plans and provides for liability for breaches of those duties. These rules are fundamentally sound and have, in fact, been highly successful for over 25 years. One problem that does exist under ERISA is that plan participants have been restricted in their ability to obtain adequate individual relief for losses to their plan accounts caused by a fiduciary breach. ASPA believes that an amendment to ERISA may be appropriate in this regard. Care must be taken, however, that changes to ERISA do not discourage employers from maintaining pension plans.

Proposals have also been made to place time limits on, or prohibit, so-called “lockdowns” or “blackouts” during which plan participants cannot change their investment options. In the experience of ASPA members, lockdown periods are necessary to permit the orderly change of plan service providers, which is often done for the purpose of improving plan features for participants. ASPA believes that advance notice of lockdowns should absolutely be required, but opposes any unnecessary restrictions on the length of lockdowns. During a lockdown, ASPA does agree, as suggested by the Administration, that ERISA could be clarified to make clear that employers bear the fiduciary responsibility of monitoring investments when employees cannot. However, while it is appropriate to impose this responsibility on employers, the Administration also needs to provide guidance to employers, particularly small businesses, on how to comply with this responsibility so it does not become a trap for the unwary.

Another issue raised by the Enron situation is the investment of plan assets in the stock of the company sponsoring the plan, usually referred to as employer stock. ASPA believes that employees should generally be provided with choice as to investing in employer stock. However, when providing choice, care must be taken to address the special concerns of small businesses whose stock is not publicly traded. Further, ASPA does have concerns about proposals to place artificial hard caps on the ability of individual participants to choose to invest in employer stock since such caps do not take into account the individual financial circumstances of each participant. For example, if an employee is covered by both a defined benefit plan and a defined contribution plan, investing a higher percentage of defined contribution assets into employer stock may be an entirely prudent investment decision due to the existence of the valuable and guaranteed defined benefit plan. Ultimately, the best protection for employees is a well-diversified investment portfolio. Consequently, employers need to be encouraged and protected in providing investment advice to plan participants. The legislation introduced by Senators Bingaman (D-NM) and Collins (R-Maine), if enacted, would effectively increase the access of plan participants to investment advice.

Finally, one of the most effective ways to strengthen the retirement security of American workers would be to revitalize the use of defined benefit plans that provide a guaranteed and insured benefit with the risk of plan investments being borne by the employer and not the employees.

An Overview of ERISA Fiduciary Responsibility

ERISA currently provides for substantive rules of fiduciary duty and enforcement actions to redress fiduciary breaches. Establishing liability for a violation of the ERISA fiduciary responsibility rules requires a showing of: (i) fiduciary or co-fiduciary status, (ii) existence of a fiduciary duty, (iii) breach of the duty, and (iv) causation of damages. The key fiduciary provisions of ERISA are summarized below.

Fiduciary Status

ERISA provides that a person is a fiduciary with respect to a plan to the extent that he or she (i) exercises any discretionary authority or discretionary control respecting management of the plan; (ii) exercises any authority or control respecting management or disposition of its assets; (iii) renders investment advice for a fee or other compensation with respect to property and assets of the plan; or (iv) has any discretionary authority or discretionary responsibility in the administration of the plan. It is key that the definition of a fiduciary under ERISA is functional. Anyone who in fact exercises discretion or control over plan assets or plan administration may be held to be a fiduciary regardless of his or her nominal title or position. ERISA requires that every employee benefit plan provide for one or more named fiduciaries that shall have authority to control and manage the operation and administration of the plan.

Fiduciary Duties

ERISA requires that a fiduciary discharge his or her duties with respect to a plan solely in the interest of the participants and beneficiaries of the plan and for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. ERISA further requires that a fiduciary act with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Fiduciaries must also diversify the investments of the plan so as to minimize the risk of large losses and act in accordance with the documents and instruments governing the plan insofar as they are consistent with the provisions of ERISA. An exception to the diversification requirement is specifically provided for the holding of qualifying employer securities by eligible individual account plans, such as 401(k) plans.

Liability for Breach of Fiduciary Duty

Section 409(a) of ERISA provides that a fiduciary of a plan who breaches his or her fiduciary duty under ERISA shall be personally liable to make good to the plan any losses to the plan resulting from the breach. A breaching fiduciary also has to restore to the plan any profits that the fiduciary has made through the use of plan assets. A court may grant any other equitable or remedial relief, as the court deems appropriate, including removal of the fiduciary.

Liability for Breach by a Co-Fiduciary

A plan fiduciary is liable for a breach of fiduciary responsibility by another plan fiduciary if (i) the fiduciary knowingly participates in, or knowingly undertakes to conceal, an act or omission of the other fiduciary while knowing that the act or omission is a breach; (ii) the fiduciary's failure to comply with his or her own specific fiduciary responsibilities has enabled the other fiduciary to commit a breach; or (iii) the fiduciary has knowledge of a breach by another fiduciary and fails to make reasonable efforts under the circumstances to remedy the breach.

Special Fiduciary Rules When Participants Can Direct Investments

ERISA Section 404(c) provides fiduciary relief for plan sponsors or any other fiduciary of the plan when participants have the right to direct the investment of assets in their accounts. If the plan provides a sufficient array of investment options in accordance with Department of Labor regulations, all fiduciaries of the plan cannot be held liable for any losses, or by reason of any fiduciary breach, which results from participants' choices of investment options.

The Need for Meaningful Remedies Under ERISA for Plan Participants

ERISA imposes stringent fiduciary duties upon persons and entities responsible for the operation of employee benefit plans, particularly with respect to the proper management, administration and investment of plan assets. The Supreme Court has recognized that ERISA is a comprehensive statute designed to promote the interests of employees in their employee benefit plans. ERISA Section 2 states it is Congressional policy to provide plan participants with appropriate remedies, sanctions and ready access to the federal courts. However, the recent large loss of retirement benefits suffered by employees of Enron has highlighted the need for increased accountability for fiduciaries who administer employee benefit plans.

Despite the strong policy of ERISA to protect the retirement benefits of employees, Supreme Court decisions interpreting the enforcement provisions of ERISA have made effective remedies unavailable to individual plan participants who are seeking redress for a breach of fiduciary duty that has caused monetary or other legal damages to their plan benefits. Many lower court decisions have decried the lack of meaningful remedies under ERISA for individual plan participants, but have stated repeatedly that only Congress can solve this problem.

While the outcome of litigation over the Enron 401(k) plan remains to be seen, a recent case demonstrates the harm to innocent plan participants resulting from the lack of meaningful remedies under ERISA for individual participants who have been damaged by a fiduciary's breach of duty. In Helfrich v. PNC Bank, Inc., 267 F.3d 477 (6th Cir. 2001), a participant in a 401(k) plan brought an action under ERISA against a plan trustee for breach of fiduciary duty. Mr. Helfrich was preparing for a distribution of his benefits and both the participant and the employer directed the plan trustee to transfer his account balance into certain mutual funds. The trustee, however, transferred the funds into a money market account instead. Mr. Helfrich brought a claim asking that the trustee compensate him for the losses he suffered because of the failure of the fiduciary to transfer his assets to the higher performing mutual funds in accordance with his instruction. The court, however, found that his requested remedy constituted money damages, not restitution, and the remedy was therefore unavailable to him under ERISA. The court noted that, while ERISA permits both plan participants and fiduciaries to sue to enforce its provisions, ERISA provides only a limited type of relief to plan participants. Although a plan fiduciary is entitled to seek the full gamut of legal and equitable relief, the courts have held that ERISA plan participants are restricted to equitable relief with no recourse to money damages. The courts have reached this restrictive result under ERISA even though, under the law of trusts, a traditional court of equity could award money damages in a lawsuit for a trustee's breach of fiduciary duty. A basic principle of trust law is that a beneficiary is entitled to a remedy that will put him in the position in which he would have been if the trustee had not committed the breach of trust.

As discussed above, ERISA Section 409(a) provides that a plan fiduciary who breaches his or her fiduciary duties under ERISA is personally liable to make good to the plan any losses to the plan resulting from the breach, and to restore to the plan any profits made by the fiduciary through use of plan assets. The fiduciary is also subject under ERISA Section 409 to other equitable or remedial relief, as the court deems appropriate. However, the Supreme Court in Massachusetts Mutual Life Ins. Co. v. Russell 473 U.S. 134 (1985) held that an individual plan participant cannot bring a claim for breach of fiduciary duty on behalf of himself under ERISA Section 409, and its corollary provision Section 502(a)(2), because these provisions provide only for relief on behalf of the plan as a whole and not to individual participants. In Russell, the Court expressly reserved the question of whether ERISA Section 502(a)(3) allows individual claims for breach of fiduciary duty.

In Varity Corp. v. Howe, 516 U.S. 489 (1996), the Supreme Court later held that Section 502(a)(3) does provide individual plan participants with a cause of action for breach of fiduciary duty. The remedies provided by Section 502(a)(3), however, are much more limited than those provided under Section 409(a). ERISA Section 502(a)(3) provides that an action can be brought by a participant, beneficiary, or fiduciary to enjoin any act or practice which violates any provision of Title I of ERISA or the terms of the plan, or to obtain other appropriate equitable relief to redress such violations or to enforce any provisions of Title I or the terms of the plan. The Supreme Court, in Mertens v. Hewitt Associates, 508 U.S. 248 (1993), specifically held that compensatory types of relief, i.e., monetary damages or legal relief, are not available in an action under Section 502(a)(3) as that section provides only for equitable relief.

ERISA was enacted to protect plan participants, particularly against the misuse of plan assets and breach of the fiduciary duty of loyalty. Restrictive Supreme Court interpretations of the enforcement provisions of ERISA have resulted in the frequent denial of meaningful remedies for individual plan participants who have been the victims of adjudicated fiduciary breaches, particularly with respect to monetary damages. ERISA needs to be amended to provide individual plan participants who have suffered losses from violations of the statute with effective remedies to make them whole and to adequately compensate their losses.

The most balanced approach to providing meaningful remedies for individual plan participants would be to amend ERISA Section 409(a) to specifically provide that individual plan participants and beneficiaries can bring actions against plan fiduciaries under Section 409(a) to obtain the remedies provided by that Section on their own behalf and not just on behalf of the plan as a whole. This legislative change would effectively overturn the decision of the Supreme Court in Massachusetts Mutual Life Ins. Co. v. Russell, as discussed above. Such an amendment would effectively increase accountability for fiduciary breaches under ERISA and would permit individual plan participants to recover compensatory damages for the loss of employee benefits in ERISA covered plans. This change would afford individual plan participants and beneficiaries the same broad range of remedies, including monetary damages, as are now available under ERISA Section 409(a) on behalf of a plan as a whole.

Some of the legislative proposals that have been quickly introduced in the wake of the Enron debacle would amend ERISA in a much more far-reaching manner and in a way that ultimately could be detrimental to the private retirement system. While the plight of the Enron employees has dramatically shown the need to make meaningful remedies available to plan participants under ERISA, care must be taken so that changes to the enforcement provisions of ERISA do not have the unintended effect of discouraging employers and plan sponsors from establishing and maintaining employee benefits plans. In particular, any amendments to ERISA should expressly state that punitive damages and consequential damages are not available in actions brought under ERISA. The need to provide meaningful remedies under ERISA must be properly balanced with the equally important need to expand pension coverage for American workers.

Lockdowns Periods Are Necessary for Plan Administration

One issue being debated in the wake of Enron is whether the law should be amended to restrict so-called "lockdowns" of defined contribution plans. A lockdown, also called a "blackout" or "transaction suspension period," is a time during which plan participants may not direct certain transactions in their retirement plan accounts, such as transfers among investment options and participant loans, or receive final distributions.

Typically a lockdown is needed when an employer changes its pension plan service provider. It is analogous to changing ordinary checking accounts. Time is required for outstanding checks to clear, and for the new account to be set up. Similarly, accurate records cannot be compiled, transmitted, and set up by the new pension plan service provider if investment changes, loan activity and/or withdrawals are ongoing during the transfer. During such a lockdown period, participant records and plan assets must be reconciled before they are turned over to the new service provider, which must then set up the recordkeeping information for the plan on its own system. If participant records are in good order, the lockdown can often be less than a week. However, it may take much longer, particularly for small business retirement plans where records may be more difficult to gather.

ASPA recently surveyed retirement plan administrators on their experiences with lockdowns. More than 250 firms responsible for administrating over 85,000 retirement plans that permit participants to direct the investment of their retirement accounts responded to the survey. On average, lockdowns for the plans surveyed lasted between three to four weeks. However, the survey indicated that lockdowns can last two months or even longer when records are difficult to gather. Finally, the survey showed that lockdowns are relatively infrequent and usually happen for a plan only once every three to four years.

Many times a lockdown is part of a process whereby a plan sponsor changes plan service providers in order to improve the investment alternatives or other plan features offered to plan participants. However, in response to the Enron bankruptcy, proposals have been made to limit the length of lockdowns or prohibit them altogether. ASPA believes these proposals are misplaced and would actually hurt plan participants. Such restrictions on lockdowns would be particularly inappropriate when a plan contains no employer stock, since there would be no opportunities for the type of manipulation, to the detriment of plan participants, that are alleged to have occurred in the Enron plan. ASPA, however, does believe that the law should be amended to require adequate notice and full disclosure to plan participants of impending lockdowns so that participants have the opportunity to make appropriate changes to their accounts in advance of a lockdown.

ASPA also agrees that, as has been suggested by the Administration, ERISA should be clarified to provide that employers have a fiduciary responsibility to monitor plan investments during a lockdown when participants are not permitted to change investment options. However, it is important to emphasize that such a proposal should not impose absolute liability for investment losses during a lockdown, such as investment losses due to typical market performance. Only when there is a fiduciary breach, should the employer be held liable. Further, it is critical that employers, particularly small businesses, be given clear guidance by the Administration on how to satisfy their fiduciary responsibilities during a lockdown. As noted earlier, lockdowns are often instituted when an employer is improving plan services for employees. Right now, because of the public controversy surrounding Enron, employers are reluctant to improve plan services for employees for fear of potential liability if they impose a lockdown. In order to give confidence to employers that they are complying with the law, guidance, including safe harbors, needs to be provided on what to do during a lockdown.

Diversification of Plan Investments

Legislative proposals have already been introduced that would limit the percentage of plan assets that may be held in employer stock. Other proposals would require that plan participants be able to diversify their plan accounts out of employer stock after varying time periods. ASPA does believe it is appropriate to reexamine the rules regarding the ability of participants to diversify the investments in their individual accounts. However, ASPA is concerned about proposals to place artificial hard caps on the ability of individual participants to choose to invest in employer stock because such caps do not take into account the individual financial circumstances of each participant. For example, if an employee is covered by both a defined benefit plan and a defined contribution plan, investing a higher percentage of defined contribution assets into employer stock may be an entirely prudent investment decision due to the existence of the valuable and guaranteed defined benefit plan.

ASPA believes that plan participants should be able to exercise free choice as to investing their plan accounts in employer stock. Participants should be able to diversify their plan investments after a reasonable time, the length of which will vary depending upon the type of plan. However, it is important that any diversification requirements take into consideration the special concerns of small businesses. Small business stock is not publicly traded, and consequently, it requires significant expense to value such stock. Generally, ERISA requires small business stock to be valued once a year. Any proposals that would require more frequent valuations would be an undue burden on small businesses.

Diversification of investments is clearly the best protection against significant losses in retirement savings. ASPA believes that the best way to promote diversification and prevent an excessive concentration of employer stock in retirement accounts is to make it easier for employers to provide investment advice to plan participants. In this respect, ASPA supports the proposed Independent Investment Advice Act (S.1677) introduced by Senator Bingaman, of this committee, and Senator Collins. According to surveys by the Profit-Sharing Council of America and the Institute of Management and Administration, the major reason employers do not currently provide investment advice to plan participants is concern about fiduciary liability. The Bingaman-Collins bill would provide employers with a safe harbor allowing them to satisfy their fiduciary obligations, thus facilitating the provision of investment advice to participants. In addition, ASPA recommends that the Department of Labor be directed to issue a model safe harbor notice to be distributed to participants that explains the advantages of diversification and the inherent risk of investing plan assets in employer stock.

Strengthening the Private Pension System

The current plight of the Enron 401(k) plan participants highlights the need to expand and reform the private pension system. This need is especially acute with respect to encouraging plan sponsors to adopt and provide defined benefit pension plans. Unlike 401(k) and other defined contribution plans, defined benefit plans provide a guaranteed retirement benefit for employees. Further, and very importantly, the employer, and not the employee, bears the risk of investing the assets of a defined benefit plan. In addition, the Pension Benefit Guaranty Corporation insures the payment of a minimum level of retirement benefits under a defined benefit plan. However, since the passage of ERISA, restrictive and complex laws have been enacted and complicated regulations issued which have seriously impeded the ability of large and small businesses alike to maintain defined benefit pension plans for their employees.

If Congress wants to provide greater retirement security for American workers, then it must do more than revise the fiduciary responsibility rules of ERISA. It is time to revitalize defined benefit plans and to once again make them attractive to both employers and employees.

On behalf of ASPA, I thank the Committee for the opportunity to present our views today. I would be glad to answer any questions that you may have.